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DESCRIPTION OF H.R. 2730 (PENSION ACCESS AND SIMPLIFICATION ACT OF 1991)

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

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CONTENTS

	Page
INTRODUCTION	1
I. SUMMARY OF THE BILL	3
A. Simplified Distribution Rules	3
B. Increased Access to Pension Plans	3
C. Miscellaneous Pension Simplification	4
II. EXPLANATION OF THE BILL	6
A. Title I—Simplified Distribution Rules (secs. 101-103)	6
B. Title II—Increased Access to Pension Plans	12
1. Simplified salary reduction arrangements for small employers (sec. 201)	12
2. Repeal of limitation on ability of State and local governments and tax-exempt employers to maintain cash or deferred arrangements (sec. 202)	14
3. Duties of master and prototype plan sponsors (sec. 203)	15
C. Title III—Miscellaneous Pension Simplification	17
1. Definition of leased employee (sec. 301)	17
2. Nondiscrimination rules relating to qualified cash or deferred arrangements, matching contributions, and after-tax employee contributions (sec. 302)	19
3. Definition of highly compensated employee, cost-of-living adjustments, half-year requirements, and plans covering self-employed individuals (secs. 303-306)	23
4. Modification of full funding limitation (sec. 307)	26
5. Distributions from qualified cash or deferred arrangements maintained by rural cooperatives (sec. 308)	27

Page

6. Special rules for plans covering pilots (sec. 309) 28
7. Elimination of special vesting rule for multi-employer plans (sec. 310) 29
8. Definition of retirement age (sec. 311)..... 30

INTRODUCTION

This pamphlet,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of H.R. 2730 (the "Pension Access and Simplification Act of 1991"). H.R. 2730 was introduced by Mr. Rostenkowski on June 24, 1991.

Part I of the pamphlet is a summary of the bill. Part II is a detailed explanation of the provisions of the bill, including present law, reasons for change, and effective dates. The bill has three titles: Title I—Simplified Distribution Rules; Title II—Increased Access to Pension Plans; and Title III—Miscellaneous Pension Simplification.

[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Description of H.R. 2730 (Pension Access and Simplification Act of 1991)* (JCS-12-91), August 5, 1991.

I. SUMMARY OF THE BILL

A. Simplified Distribution Rules

Rollover rules

The bill allows an employee or surviving spouse to roll over any portion of a distribution he or she receives from a qualified retirement plan, unless the distribution is (1) a minimum distribution required under the Internal Revenue Code or (2) part of a stream of annuity payments payable over a period of 5 years or more, or over the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and his or her beneficiary.

Lump-sum distributions, net unrealized appreciation, and employer-provided death benefits

The bill repeals (1) 5-year forward income averaging for lump-sum distributions, (2) the exclusion of net unrealized appreciation of employer securities, and (3) the $5,000 death benefit exclusion. Effective in 1993, the bill also repeals the grandfather rule under the Tax Reform Act of 1986 that allowed certain individuals to elect 5- or 10-year averaging and capital gains treatment. Under a special transition rule, taxpayers can elect to apply the grandfather rule with respect to 50 percent of a lump-sum distribution received in 1992. The other 50 percent is subject to the new rules under the bill and could, for example, be rolled over tax free under the rollover provisions of the bill.

Recovery of basis

The bill provides a simplified rule under which individuals can determine the portion of a pension distribution that represents nontaxable return of basis.

Direct transfers to IRAs or other eligible transferee plans

The bill requires plans to allow participants to elect to have distributions transferred directly to another qualified plan or IRA rather than receiving the distribution themselves. To give employers sufficient time to implement this rule, the requirement does not take effect until 1993.

B. Increased Access to Pension Plans

Simplified salary reduction plan for small employers

The bill establishes a new simplified retirement program for employees of small businesses. Employers with 100 or fewer employees and no other retirement plan are relieved from testing for nondiscrimination if they make a base contribution of 3 percent of pay (up to $100,000) for each eligible employee. Employers who terminate another plan to establish a simplified plan are required to

contribute 5 percent of pay. Employees can elect to contribute additional amounts to the plan up to $5,000 on a pre-tax basis. Also, employers can match up to 50 percent of each employee's contribution. These programs are available to qualifying private employers, State and local governments, and tax-exempt organizations.

Repeal of limitation on ability of State and local governments and tax-exempt employers to maintain cash or deferred arrangements

The bill makes cash or deferred arrangements available to tax-exempt employers beginning in 1992, and to State and local governments beginning in 1995.

Duties of master and prototype plan sponsors

The bill permits the Internal Revenue Service to prescribe rules defining the duties and responsibilities of sponsors of preapproved master and prototype retirement plans. These plans can be adopted by employers to relieve them of the burden of keeping abreast of changes in retirement plan law and amending their plans to conform with such changes.

C. Miscellaneous Pension Simplification

Definition of leased employee

The bill narrows the application of the employee leasing rules by repealing the present-law "historically performed" test and replacing it with a "direction or control" test.

Nondiscrimination rules relating to qualified cash or deferred arrangements

The bill replaces the present-law two-prong nondiscrimination test for elective contributions under cash or deferred arrangements with a single test that is applied at the beginning of each year. Under the test, each highly compensated employee may defer up to 200 percent of the average deferral percentage of eligible nonhighly compensated employees for the prior year. A similar rule applies to employer matching and employee after-tax contributions.

Other miscellaneous pension simplification provisions

Definition of highly compensated employee

The bill narrows the definition of highly compensated employee by defining a highly compensated employee as someone who makes more than $65,000 (indexed) or is a 5-percent owner. The bill also eliminates the family aggregation rules for employees who are not 5-percent owners and reduces the number of family members that must be aggregated.

Cost-of-living adjustments

The bill requires that the cost-of-living increases to qualified plan dollar limits be published before the beginning of the plan year, and that such limits be rounded to the nearest $1,000 or $100.

Half-year requirements

The bill changes the rules under present law that are keyed to ages 59-1/2 and 70-1/2 to ages 59 and 70, respectively.

Plans covering self-employed individuals

The bill conforms most of the rules governing Keogh plans to those applicable to other qualified plans.

Modification of full funding limitation

The bill permits certain employers to elect an alternative full funding limitation with respect to any defined benefit plan based solely on the accrued liability under the plan. The Secretary is required to adjust the 150-percent of current liability full funding limit for other plans so than the provision is revenue neutral. This provision is effective on the date of enactment.

Distributions from qualified cash or deferred arrangements maintained by rural cooperatives

The bill conforms the rules for distributions from cash or deferred arrangements by providing that a rural cooperative plan that includes a qualified cash or deferred arrangement will not be disqualified merely by reason of a distribution to a participant after the attainment of age 59.

Special rules for plans covering pilots

The bill treats certain nonunion air pilots as a separate class of employees for nondiscrimination testing purposes.

Elimination of special vesting rule for multiemployer plans

The bill requires multiemployer plans to comply with the vesting schedules applicable to other qualified plans by eliminating the special 10-year cliff vesting schedule available to such plans under present law. This provision applies to plan years beginning after the expiration of the collective bargaining agreement pursuant to which the plan is maintained, but not later than the 1994 plan year.

8. Definition of retirement age

The bill provides that the social security retirement age (not age 65) is generally the maximum normal retirement age.

D. Effective Dates

Except as otherwise indicated above, the provisions of the bill generally are effective for years beginning after December 31, 1991.

II. EXPLANATION OF THE BILL

A. Title I—Simplified Distribution Rules (secs. 101-103 of the bill and secs. 72, 101(b), 401, 402, and 403 of the Code)

Present Law

In general

Under present law, a distribution of benefits from a tax-favored retirement arrangement generally is includible in gross income in the year it is paid or distributed under the rules relating to the taxation of annuities. A tax-favored retirement arrangement includes (1) a qualified pension plan (sec. 401(a)), (2) a qualified annuity plan (sec. 403(a)) and (3) a tax-sheltered annuity (sec. 403(b)). Special rules apply in the case of lump-sum distributions from a qualified plan, distributions that are rolled over to an individual retirement arrangement (IRA), distributions of employer securities, and employer-provided death benefits.

Rollovers

Under present law, a total or partial distribution of the balance to the credit of an employee under a qualified plan, a qualified annuity plan, or a tax-sheltered annuity may, under certain conditions, be rolled over tax free to an IRA or another qualified plan or annuity (secs. 402(a), 403(a), and 403(b)). A rollover of a partial distribution is permitted if (1) the distribution equals at least 50 percent of the balance to the credit of the employee, (2) the distribution is not one of a series of periodic payments, (3) the distribution is made on account of death, disability, or separation from service, and (4) the employee elects rollover treatment. A partial distribution may only be rolled over to an IRA and not to another qualified plan.

The maximum amount of a distribution that can be rolled over is the amount of the distribution that would otherwise be taxable. That is, after-tax employee contributions cannot be rolled over. In addition, minimum required distributions (sec. 401(a)(9)) may not be rolled over. The rollover must be made within 60 days after the distribution is received.

Lump-sum distributions

Under present law, lump-sum distributions from qualified plans and annuities are eligible for special 5-year forward income averaging (sec. 402(e)). In general, a lump-sum distribution is a distribution within one taxable year of the balance to the credit of an employee which becomes payable to the recipient (1) on account of the death of the employee, (2) after the employee attains age 59-1/2, (3) on account of the employee's separation from service, or (4) in the case of self-employed individuals, on account of disability. In addi-

tion, a distribution is treated as a lump-sum distribution only if the employee has been a participant in the plan for at least 5 years before the year of the distribution. Lump-sum treatment is not available for distributions from tax-sheltered annuity contracts (sec. 403(b)).

A taxpayer is permitted to make an election with respect to a lump-sum distribution received on or after the employee attains age 59-1/2 to use 5-year forward income averaging under the tax rates in effect for the taxable year in which the distribution is made. However, only one such election on or after age 59-1/2 may be made with respect to any employee.

Special transition rules adopted in the Tax Reform Act of 1986 are available with respect to an employee who attained age 50 before January 1, 1986. Under these rules, an individual, trust, or estate may elect to use 5-year forward averaging (using present-law tax rates) or 10-year forward income averaging (using the tax rates in effect prior to the Tax Reform Act of 1986) with regard to a single lump-sum distribution, without regard to whether the employee has attained age 59-1/2. In addition, an individual, trust, or estate receiving a lump-sum distribution with respect to such employee may elect to retain the capital gains character of the pre-1974 portion of the lump-sum distribution (using a tax rate of 20 percent).

Net unrealized appreciation

Under present law, a taxpayer is not required to include in gross income amounts received in the form of a lump-sum distribution to the extent that the amounts are attributable to net unrealized appreciation in employer securities (sec. 402(a)). Such unrealized appreciation is includible in gross income when the securities are sold or exchanged. The special treatment of net unrealized appreciation applies only if a valid lump-sum distribution election is made, but disregarding the 5 plan years of participation requirement for lump-sum distributions.

In addition, gross income does not include net unrealized appreciation on employer securities attributable to employee contributions, regardless of whether the securities are received in a lump-sum distribution. Such appreciation is includible in income when the securities are disposed of.

Employer-provided death benefits

Under present law, the beneficiary or estate of a deceased employee generally can exclude up to $5,000 in benefits paid by or on behalf of an employer by reason of the employee's death (sec. 101(b)).

Recovery of basis

Qualified plan distributions other than lump-sum distributions generally are includible in gross income in the year they are paid or distributed under the rules relating to taxation of annuities (sec. 402). Amounts received as an annuity generally are includible in income in the year received, except to the extent they represent the return of the recipient's investment in the contract (i.e., basis) (sec. 72). Under present law, a pro-rata basis recovery rule general-

ly applies, so that the portion of any annuity payment that represents nontaxable return of basis is determined by applying an exclusion ratio equal to the employee's total investment in the contract divided by the total expected payments over the term of the annuity. The total expected payments depends on the form of the payment, e.g., a single-life annuity, an annuity with payments guaranteed for a specified number of years, or a joint and survivor annuity. For example, if benefits are paid in the form of an annuity during the life of the employee, the expected payments are calculated by multiplying the annual payment amount by the employee's life expectancy on the annuity starting date. If benefits are paid in the form of a joint and survivor annuity, then the total expected return depends on the life expectancies of both the primary annuitant and the person who is to receive the survivor annuity. The IRS has issued tables of life expectancies that are used to calculate expected returns.

Under a simplified alternative method provided by the Internal Revenue Service (IRS) (Notice 88-118) for payments from or under qualified retirement arrangements, the taxable portion of qualifying annuity payments is determined under a simplified exclusion ratio method. Under the simplified method, the portion of each annuity payment that represents nontaxable return of basis is equal to the employee's total investment in the contract (including the $5,000 death benefit exclusion under section 101(b), to the extent applicable), divided by the number of anticipated payments listed in a table published by the IRS. The number of anticipated payments listed in the table is based on the employee's age on the annuity starting date. The simplified method is available if (1) the annuity payments depend on the life expectancy of the recipient (or the joint lives of the recipient and his or her beneficiary), and (2) the recipient is less than age 75 on the annuity starting date or there are fewer than 5 years of guaranteed payments under the annuity.

Under both the pro rata and simplified alternative methods, in no event will the total amount excluded from income as nontaxable return of basis be greater than the recipient's total investment in the contract.

Reasons for Change

In almost all cases, the burden of determining the extent to which and how a distribution from a qualified plan, tax-sheltered annuity, or IRA is taxed rests with the individual receiving the distribution. Under present law, this task can be burdensome. Among other things, the taxpayer must consider (1) whether special tax rules (e.g., 5- or 10-year income averaging or the special treatment of net unrealized appreciation) apply that reduce the tax that otherwise would be paid, (2) whether the distribution is eligible to be rolled over to another qualified plan, tax-sheltered annuity, or IRA, (3) the amount of the taxpayer's basis in the plan, annuity, or IRA and the rate at which such basis is to be recovered, and (4) whether or not a portion of the distribution is excludable from income as a death benefit. Simplifying these rules could benefit as many as 16 million individual taxpayers.

The number of special rules for taxing pension distributions makes it difficult for taxpayers to determine which method is best for them and also increases the likelihood of error. In addition, the specifics of each of the rules create complexity. For example, the present-law rules for determining the rate at which a participant's basis in a qualified plan is recovered often entail calculations that the average participant has difficulty performing. These rules require a fairly precise estimate of the period over which benefits are expected to be paid. The IRS publication on taxation of pension distributions (Publication 939) contains over 60 pages of actuarial tables used to determine total expected payments.

The complexity of the restrictions on rollovers under present law (e.g., the 60-day rule) lead to numerous inadvertent failures to satisfy the rollover requirements. The rules relating to net unrealized appreciation in employer securities create recordkeeping and basis-tracking problems for participants and the IRS and treat distributions of employer securities more favorably than other distributions from qualified plans.

Results similar to those under present law can be obtained without the complexity added by the special tax rules of present law. For example, liberalization of the rollover rules will increase the flexibility of taxpayers in determining the timing of the income inclusion of pension distributions and eliminate the need for special rules such as 5- and 10-year averaging and the special rules for unrealized appreciation on employer securities.

Explanation of Provisions

In general

The bill expands the circumstances in which a distribution may be rolled over tax free and, in conjunction with such expansion, repeals 5- and 10-year averaging for lump-sum distributions from qualified plans, the special rules for unrealized appreciation in employer securities, and the $5,000 death benefit exclusion. The bill also simplifies the basis recovery rules applicable to distributions from qualified plans and requires that qualified plans give participants the option of having a distribution transferred directly to an IRA.

Rollovers

Under the bill, any portion of any distribution to the employee or the surviving spouse of the employee (other than a minimum required distribution (sec. 401(a)(9)) may be rolled over tax free to an IRA or another qualified plan or annuity, unless the distribution is part of a series of substantially equal payments made (1) over the life (or life expectancy) of the participant or the joint lives (or joint life expectancies) of the participant and his or her beneficiary, or (2) over a specified period of 5 years or more. The present-law prohibition on rolling over employee contributions is retained due to recordkeeping concerns.

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Lump-sum distributions

The bill repeals the general 5-year forward averaging rule, as well as the transition rules under the Tax Reform Act of 1986 relating to 5- and 10-year averaging and capital gains treatment.

Net unrealized appreciation

The bill also repeals the exclusion from income of net unrealized appreciation of employer securities. Distributions of employer securities are taxed the same as other distributions.

Employer-provided death benefits

Under the bill, the exclusion from gross income of up to $5,000 in employer-provided death benefits is repealed.

Recovery of basis

Under the bill, the portion of an annuity distribution from a qualified retirement plan, qualified annuity, or tax-sheltered annuity that represents nontaxable return of basis generally is determined under a method similar to the present-law simplified alternative method provided by the Internal Revenue Service. Under the simplified method provided in the bill, the portion of each annuity payment that represents nontaxable return of basis generally is equal to the employee's total investment in the contract as of the annuity starting date, divided by the number of anticipated payments determined by reference to the age of the participant listed in the table set forth in the bill. The number of anticipated payments listed in the table is based on the employee's age on the annuity starting date. If the number of payments is fixed under the terms of the annuity, that number is to be used instead of the number of anticipated payments listed in the table.

The simplified method does not apply if the primary annuitant has attained age 75 on the annuity starting date unless there are fewer than 5 years of guaranteed payments under the annuity. If in connection with commencement of annuity payments, the recipient receives a lump-sum payment that is not part of the annuity stream, such payment is taxable under the rules relating to annuities (sec. 72) as if received before the annuity starting date, and the investment in the contract used to calculate the simplified exclusion ratio for the annuity payments is reduced by the amount of the payment. As under present law, in no event will the total amount excluded from income as nontaxable return of basis be greater than the recipient's total investment in the contract.

Direct transfers to IRAs or other eligible transferee plans

Under the bill, a qualified retirement or annuity plan must permit participants to elect to have any distribution that is eligible for rollover treatment transferred directly to an eligible transferee plan specified by the participant. An eligible transferee plan is an IRA or a qualified retirement (sec. 401(a)) or annuity plan (sec. 403(a)). As under present law, a transfer cannot be made to another qualified plan unless the transferee plan provides for the transfer to be accepted. Amounts transferred to an eligible transferee plan

are includible in income when distributed from the transferee plan in accordance with the rules applicable to that plan.

Before making an eligible rollover distribution, the plan administrator is required to provide a written explanation to the participant of the direct transfer option. When making a distribution not in the form of a direct transfer, the administrator must provide a written explanation of the 60-day rollover limitation period.

Effective Dates

The provisions are generally effective for years beginning after December 31, 1991.

The grandfather rules under the Tax Reform Act of 1986 and the present-law 5-year averaging provision apply to 50 percent of any lump-sum distribution received in taxable years beginning in 1992. The other 50 percent of such a distribution is subject to the rules of the bill regarding taxation of distributions and may, for example, be rolled over tax free under the rollover provisions of the bill. The repeal of the grandfather rules under the Tax Reform Act of 1986 applies to amounts distributed in a taxable year beginning after December 31, 1992.

The provision relating to trustee-to-trustee transfers is effective for years beginning after December 31, 1992.

B. Title II—Increased Access to Pension Plans

1. Simplified salary reduction arrangements for small employers (sec. 201 of the bill and sec. 408(k)(6) of the Code)

Present Law

Under present law, certain employers (other than tax-exempt and governmental employers) can establish a simplified employee pension (SEP) for the benefit of their employees under which the employees can elect to have contributions made to the SEP or to receive the contributions in cash (sec. 408(k)(6)). If an employee elects to have contributions made on the employee's behalf to the SEP, the contribution is not treated as having been distributed or made available to the employee. In addition, the contribution is not treated as an employee contribution merely because the SEP provides the employee with such an election. Therefore, an employee is not required to include in income currently the amounts the employee elects to have contributed to the SEP. Elective deferrals under a SEP are to be treated in the same manner as elective deferrals under a qualified cash or deferred arrangement and, thus, are subject to the $8,475 (indexed) cap on elective deferrals.

The election to have amounts contributed to a SEP or received in cash is available only if at least 50 percent of the employees of the employer elect to have amounts contributed to the SEP. In addition, such election is available for a taxable year only if the employer maintaining the SEP had 25 or fewer eligible employees at all times during the prior taxable year.

Under present law, elective deferrals under SEPs are subject to nondiscrimination standards. The amount eligible to be deferred as a percentage of each highly compensated employee's compensation (i.e., the deferral percentage) is limited by the average deferral percentage (based solely on elective deferrals) for all nonhighly compensated employees who are eligible to participate. The deferral percentage for each highly compensated employee (taking into account only the first $222,220 (indexed) of compensation) cannot exceed 125 percent of the average deferral percentage for all other eligible employees. Nonelective SEP contributions may not be combined with the elective SEP deferrals for purposes of this test. An employer may not make any other SEP contributions conditioned on elective SEP deferrals. If the 125-percent test is not satisfied, rules similar to the rules applicable to excess contributions to a cash or deferred arrangement is to apply.

If any employee is eligible to make elective SEP deferrals, all employees satisfying the participation requirements must be eligible to make elective SEP deferrals. Employees satisfying the participation requirements are those employees who (1) have attained age 21, (2) have performed services for the employer during at least 3 of the immediately preceding 5 years, and (3) received at least $363 (indexed) in compensation from the employer for the year. An employee can participate even though he or she is also a participant in one or more other qualified retirement plans sponsored by the employer. However, SEP contributions are added to the employer's contribution to the other plans on the participant's behalf in applying the limits on contributions and benefits (sec. 415).

Reasons for Change

Although generous, the tax incentives for pension plans under present law have not significantly improved pension coverage for employees of small businesses. One of the reasons small employers may fail to establish pension plans for employees is because of the administrative costs and burdens attributable to such plans.

While present-law SEPs already provide a low-cost retirement savings option to employers, it is believed that further simplification and broadening of the SEP rules will encourage more small employers to establish plans for their employees. In particular, it is believed that making salary deferral SEPs available to a larger number of employers and providing a design-based qualification test for such SEPs (in lieu of applying nondiscrimination standards) will encourage small employers to establish plans for their employees.

The exemption from nondiscrimination standards for small employer salary deferral SEPs is a departure from the rule that tax-favored retirement plans must be tested for prohibited discrimination in favor of highly compensated employees. In general, nondiscrimination rules are critical to both sound tax and retirement policy. However, because of the complexity of the present-law rules and the resulting burden they place on small employers, a targeted exception to the general rule is appropriate for small employers. In all other cases, nondiscrimination testing will continue to apply.

Explanation of Provisions

The bill repeals the present-law rules applying to salary reduction arrangements under a SEP and replaces them with new rules that simplify the administration of such arrangements.

Under the bill, employers (including tax-exempt and State and local government employers) who do not maintain a qualified plan and who had no more than 100 employees eligible to participate in a SEP on each day of the preceding plan year can maintain a qualified salary reduction arrangement for their employees. The arrangement must satisfy the following requirements to be a qualified arrangement. First, the employer must contribute to each eligible employee's SEP an amount equal to 3 percent of the employee's compensation for the year (not in excess of $100,000 (indexed)). This percentage is increased to 5 percent if the employer or any predecessor employer maintained a qualified plan (other than a SEP) during either of the 2 years preceding the year in which the salary deferral SEP is established.

Second, each eligible employee must be permitted to make salary reduction contributions to the SEP of up to a maximum of $5,000 (indexed) per year.[2]

Third, the employer may make matching contributions to each employee's SEP equal to no more than 50 percent of the elective contributions made on behalf of the employee. The level of the employer's matching contribution may not increase as an employees elective contribution increases, and may not be greater for any

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[2] Of course, the employer may limit contributions to the extent necessary to ensure compliance with the limits on contributions and benefits (sec. 415).

highly compensated employee at any level of compensation than for any nonhighly compensated employee at that level.

If these conditions are satisfied, the arrangement is a qualified salary reduction arrangement that can be maintained under a SEP. The qualified arrangement is not subject to nondiscrimination testing requirements. In addition, it is intended that a qualified salary reduction arrangement will be deemed to satisfy the minimum benefit requirements of the top-heavy rules (sec 416(c)(2)).

Under the bill, an employer maintaining a salary reduction SEP is required to provide a description of the SEP to eligible employees.

Effective Date

The provision is generally effective with respect to years beginning after December 31, 1991.

Under a transition rule, salary reduction SEPs established before the date of enactment are not subject to the new rules contained in the bill regarding qualified salary reduction arrangements unless the employer elects to have the new rules apply for any year and all subsequent years. Employers who do not make such an election are subject to the rules in effect for years beginning before January 1, 1992.

2. Repeal of limitation on ability of State and local governments and tax-exempt employers to maintain cash or deferred arrangements (sec. 202 of the bill and secs. 401(k) and 408(k)(6) of the Code)

Present Law

Under present law, if a tax qualified profit-sharing or stock bonus plan meets certain requirements, then an employee is not required to include in income any employer contributions to the plan merely because the employee could have elected to receive the amount contributed in cash (sec. 401(k)). Plans containing this feature are referred to as cash or deferred arrangements. State and local governments and tax-exempt organizations are generally prohibited from establishing qualified cash or deferred arrangements. Because of this limitation, many of such employers are precluded from maintaining broad-based, funded elective deferral arrangements for their employees.

Reasons for Change

State and local governments and tax-exempt entities should be permitted to maintain cash or deferred arrangements for their employees on the same basis as other employers.

Explanation of Provision

The bill allows State and local governments and tax-exempt organizations to maintain cash or deferred arrangements. As under present law, the limitation on the amount that may be deferred by an individual participating in both a cash or deferred arrangement and another elective deferral arrangement applies.

Effective Date

The provision applies to tax-exempt organizations with respect to plans established after December 31, 1991, and to governmental employers with respect to plans established after December 31, 1994.

3. Duties of master and prototype plan sponsors (sec. 203 of the bill)

Present Law

The Internal Revenue Service (IRS) master and prototype program is an administrative program under which trade and professional associations, banks, insurance companies, brokerage houses, and other financial institutions can obtain IRS approval of model retirement plan language and then make these preapproved plans available for adoption by their customers, investors, or association members. Rules regarding who can sponsor master and prototype programs, the prescribed format of the model plans, and other matters relating to the program are contained in revenue procedures and other administrative pronouncements of the IRS.

The IRS also maintains related administrative programs that authorize advance approval of model plans prepared by law firms and others, i.e., the regional prototype plan program and volume submitter program.

Reasons for Change

As the laws relating to retirement plans have become more complex, employers have experienced an increase in the frequency and cost of amending plans and of the burdens of administering the plans. Master and prototype plans reduce these costs and burdens, particularly for small- to medium-sized employers, and improve IRS administration of the retirement plan rules. Today, the majority of employer-provided qualified retirement plans, including qualified cash or deferred arrangements (sec. 401(k) plans), simplified employee pensions (SEPs) and individual retirement arrangements (IRAs) are approved master and prototype plans. The Treasury and the IRS believe that the further expansion of the master and prototype program is desirable, but that statutory authority authorizing the IRS to specifically define the duties of master and prototype sponsors should be obtained before the program becomes more widely utilized.

Explanation of Provision

The bill authorizes the IRS to define the duties of organizations that sponsor master and prototype regional prototype, and other preapproved plans, including mass submitters. These duties would become a condition of sponsoring preapproved plans. The bill is not intended to be interpreted as diminishing the IRS's administrative authority with respect to the master and prototype, regional prototype, or similar programs, including the authority to define who is eligible to sponsor prototype plans, or to create other rules relating to these programs. Rather, it is intended to create a system of spon-

sor accountability, subject to IRS monitoring, that will give adopters of master and prototype and other preapproved plans a level of protection, comparable to that in the regional prototype plan program, against failure by master and prototype and other plan sponsors to fulfill certain obligations.

The bill thus authorizes the IRS to prescribe duties of sponsors of prototype and other preapproved plans that include, but are not limited to, maintaining annually current lists of adopting employers and providing certain annual notices to adopting employers and to the IRS. While reflecting the IRS's own requirements in its regional prototype plan procedure, the bill does not require the IRS to mandate a master and prototype accountability system that is identical to the regional prototype plan procedure. The bill also authorizes the IRS to prescribe such other reasonable duties that are consistent with the objective of protecting adopting employers from a sponsor's failure to amend a plan in a timely manner or to communicate amendments or other notices required by the IRS's procedures.

The bill authorizes the IRS to define the duties of preapproved plan sponsors that relate to providing administrative services to the plans of adopting employers. This is not intended to obligate sponsors to undertake the complete day-to-day administration of the plans they sponsor (although it does not preclude the IRS from mandating the performance of specific functions), but to protect employers against loss of qualification merely because of ignorance of the possible need to arrange for such services or the unavailability of professional assistance from parties familiar with the sponsor's plan.

It is thus intended that, at a minimum, sponsors should (1) advise adopting employers that failure to arrange for administrative services to the plan may significantly increase the risk of disqualification and resulting sanctions, and (2) furnish employers with the name of firms that are familiar with the plan and can provide professional administrative service. Of course, this would not preclude the sponsor from providing that service itself.

The bill should not be construed as creating fiduciary relationships or responsibilities under Title I of ERISA that would not exist in the absence of the provision.

To the extent he deems reasonably necessary to carry out the purposes of this provision of the bill, the Secretary is authorized to issue regulations that permit the relaxation of the anti-cutback rules contained in ERISA (sec. 204(g)) and the Code (sec. 411(d)(6)) when employers replace an individually designed plan with an IRS model plan, provided that the rights of participants to accrued benefits under the individually designed plan are not significantly impaired. This will facilitate the shift by employers from individually designed plans to IRS model plans.

C. Title III—Miscellaneous Pension Simplification

1. Definition of leased employee (sec. 301 of the bill and sec. 414(n) of the Code)

Present Law

An individual (a leased employee) who performs services for another person (the recipient) may be required to be treated as the recipient's employee for various employee benefit provisions if the services are performed pursuant to an agreement between the recipient and a third person (the leasing organization) who is otherwise treated as the individual's employer (sec. 414(n)). The individual is to be treated as the recipient's employee only if the individual has performed services for the recipient on a substantially full-time basis for a year, and the services are of a type historically performed by employees in the recipient's business field.

An individual who otherwise would be treated as a recipient's leased employee will not be treated as such an employee if the individual participates in a safe harbor plan maintained by the leasing organization meeting certain requirements. Each leased employee is to be treated as an employee of the recipient, regardless of the existence of a safe-harbor plan, if more than 20 percent of an employer's nonhighly compensated workforce are leased.

Reasons for Change

The leased employee rules are complex and have unexpected and sometimes indefensible results, especially as interpreted under regulations proposed by the Secretary. For example, under the "historically performed" standard, the employees and partners of a law firm may be the leased employees of a client of the firm if they work a sufficient number of hours for the client and if it is not unusual for employers in that business field to have in-house counsel. While arguably meeting the present-law leased employee definition, situations such as this are outside the originally intended scope of the rules.

Explanation of Provision

Under the bill, the present-law "historically performed" test is replaced with a new rule defining who must be considered a leased employee. Under the bill, an individual is not considered a leased employee unless the services are performed under any significant direction or control by the service recipient. As under present law, the determination of whether someone is a leased employee is made after determining whether the individual is a common-law employee of the service recipient. Thus, an individual who is not a common-law employee of the service recipient may nevertheless be a leased employee of the service recipient. Similarly, the fact that a person is or is not found to perform service under the significant direction or control of the recipient for purposes of the employee leasing rules is not relevant in determining whether the person is or is not a common-law employee of the recipient.

Whether a service recipient has significant direction or control over the services performed by an individual depends on the facts

and circumstances. Factors that are relevant in determining whether significant direction or control exists include whether the individual is required to comply with instructions of the service recipient about when, where, and how he or she is to work, whether the services must be performed by a particular person, whether the individual is subject to the supervision of the service recipient, and whether the individual must perform services in the order or sequence set by the service recipient. Factors that would generally not be relevant in determining whether such direction or control exists include whether the service recipient has the right to hire or fire the individual, whether the individual works for others, and whether the individual has a significant investment in facilities or equipment used by the individual in performing the services.

For example, an individual who works under the direct supervision of the service recipient would be considered to be subject to the significant direction or control of the service recipient even if another company hired and trained the individual, had the ultimate (but unexercised) legal right to control the individual, paid his wages, withheld his employment and income taxes, and had the exclusive right to fire him.

On the other hand, an individual who is a common-law employee of Company A who performs services for Company B on the business premises of the Company B under the supervision of Company A would generally not be considered to be under the direction or control of Company B. The supervision by Company A must be more than nominal, however, and not merely a mechanism to avoid the literal language of the direction or control test.

Under the direction or control test, clerical and similar support staff (e.g., secretaries and nurses) generally would be considered to be subject to the direction or control of the service recipient and would be leased employees provided the other requirements of section 414(n) are met.

In many cases, the present-law "historically performed" test is overbroad, and results in the unintended treatment of individuals as leased employees. One of the principal purposes for adopting the significant direction or control test is to relieve the unnecessary hardship and uncertainty created for employers in these circumstances. However, it is not intended that the direction or control test enable employers to engage in abusive practices. Thus, it is intended that the Secretary interpret and apply the leased employee rules in a manner so as to prevent abuses. This ability to prevent abuses under the leasing rules is in addition to the present-law authority of the Secretary under section 414(o). For example, one potentially abusive situation exists where the benefit arrangements of the service recipient overwhelmingly favor its highly compensated employees, the employer has no or very few nonhighly compensated common-law employees, yet the employer makes substantial use of the services of nonhighly compensated individuals who are not its common-law employees.

Effective Date

The provision is effective for taxable years beginning after December 31, 1991. In applying the leased employee rules to years be-

ginning before such date, it is intended that the Secretary use a reasonable interpretation of the statute to apply the leasing rules to prevent abuse. The changes to the leasing rules are not intended to affect grandfather rules granted under prior legislation.

2. Nondiscrimination rules relating to qualified cash or deferred arrangements, matching contributions, and after-tax employee contributions (sec. 302 of the bill and secs. 401(k) and (m) of the Code)

Present Law

Nondescrimination rules relating to qualified cash or deferred arrangements

In general

A profit-sharing or stock bonus plan, a pre-ERISA money purchase pension plan, or a rural cooperative plan may include a qualified cash or deferred arrangement (sec. 401(k)). Under such an arrangement, an employee may elect to have the employer make payments as contributions to a plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals. The maximum annual amount of elective deferrals that can be made by an individual is $8,475 for 1991. This dollar limit is indexed annually for inflation. A special nondiscrimination test applies to cash or deferred arrangements.

The special nondiscrimination test applicable to elective deferrals under qualified cash or deferred arrangements is satisfied if the actual deferral percentage (ADP) for eligible highly compensated employees for a plan year is equal to or less than either (1) 125 percent of the ADP of all nonhighly compensated employees eligible to defer under the arrangement, or (2) the lesser of 200 percent of the ADP of all eligible nonhighly compensated employees or such ADP plus 2 percentage points. The ADP for a group of employees is the average of the ratios (calculated separately for each employee in the group) of the contributions paid to the plan on behalf of the employee to the employee's compensation.

Excess contributions

If the special nondiscrimination rules are not satisfied for any year, the qualified cash or deferred arrangement will not be disqualified if the excess contributions (plus income allocable to the excess contributions) are distributed before the close of the following plan year. In addition, under Treasury regulations, instead of receiving an actual distribution of excess contributions, an employee may elect to have the excess contributions treated as an amount distributed to the employee and then contributed by the employee to the plan on an after-tax basis.

Excess contributions mean, with respect to any plan year, the excess of the aggregate amount of elective deferrals paid to the cash or deferred arrangement and allocated to the accounts of highly compensated employees over the maximum amount of elective deferrals that could be allocated to the accounts of highly compensated employees without violating the nondiscrimination re-

quirements applicable to the arrangement. To determine the amount of excess contributions and the employees to whom the excess contributions are to be distributed, the elective deferrals of highly compensated employees are reduced in the order of their actual deferral percentages beginning with those highly compensated employees with the highest deferral percentages.

Excise tax on excess contributions

An excise tax is imposed on the employer making excess contributions to a qualified cash or deferred arrangement (sec. 4979). The tax is equal to 10 percent of the excess contributions (but not earnings on those contributions) under the arrangement for the plan year ending in the taxable year. However, the tax does not apply to any excess contributions that, together with income allocable to the excess contributions, are distributed or, in accordance with Treasury regulations, recharacterized as after-tax employee contributions no later than 2-1/2 months after the close of the plan year to which the excess contributions relate.

Excess contributions (plus income) distributed or recharacterized within the applicable 2-1/2-month period generally are to be treated as received and earned by the employee in the employee's taxable year in which the excess contributions would have been received as cash, but for the employee's deferral election. For purposes of determining the employee's taxable year in which the excess contributions are includible in income, the excess contributions are treated as the first contributions made for a plan year. Of course, distributions of excess contributions (plus income) within the applicable 2-1/2-month period are not taxed a second time in the year of distribution.

Nondiscrimination rules relating to employer matching contributions and after-tax employee contributions

In general

A special nondiscrimination test is applied to employer matching contributions and after-tax employee contributions under qualified defined contribution plans (sec. 401(m)) that is similar to the special nondiscrimination test applicable to qualified cash or deferred arrangements.[3] The term "employer matching contributions" means any employer contribution made on account of (1) an employee contribution or (2) an elective deferral under a qualified cash or deferred arrangement.

The special nondiscrimination test is satisfied for a plan year if the contribution percentage for eligible highly compensated employees does not exceed the greater of (1) 125 percent of the contribution percentage for all other eligible employees, or (2) the lesser of 200 percent of the contribution percentage for all other eligible employees, or such percentage plus 2 percentage points. The contribution percentage for a group of employees for a plan year is the average of the ratios (calculated separately for each employee in the group) of the sum of matching and employee contributions on

[3] These rules also apply to certain employee contributions to a defined benefit pension plan.

behalf of each such employee to the employee's compensation for the year.

Under Treasury regulations, multiple use of the second (or "alternative") limitation cannot be used to satisfy both the special nondiscrimination test in section 401(k) and the special nondiscrimination test in section 401(m) in the case of a plan that includes both a qualified cash or deferred arrangement and matching contributions.

Treatment of excess aggregate contributions

As under the rules relating to qualified cash or deferred arrangements, if the special nondiscrimination test is not satisfied for any year, the plan will not be disqualified if the excess aggregate contributions (plus income allocable to such excess aggregate contributions) are distributed before the close of the following plan year. Generally, the amount of excess aggregate contributions and their allocation to highly compensated employees is determined in the same manner as with respect to excess deferrals.

Excise tax on excess aggregate contributions

An excise tax is imposed on the employer with respect to excess aggregate contributions (sec. 4979). The tax is equal to 10 percent of the excess aggregate contributions (but not earnings on those contributions) under the plan for the plan year ending in the taxable year for which the contributions are made.

However, the tax does not apply to any excess aggregate contributions that, together with income allocable to the excess aggregate contributions, are distributed (or, if nonvested, forfeited) no later than 2-1/2 months after the close of the plan year in which the excess aggregate contributions arose.

Reasons for Change

The sources of complexity generally associated with the special nondiscrimination test for qualified cash or deferred arrangements are the recordkeeping necessary to monitor employee elections, the calculations involved in applying the test, and the correction mechanism, i.e., what to do if the plan fails the test. The correction mechanism can create problems because the employer often will not know until the end of the year whether or not the test has been satisfied. The need to make corrections at the end of the year can create confusion on the part of employees who receive a return of their excess contributions. Although perhaps more a question of fairness rather than complexity, it has also been pointed out that the way in which excess contributions of highly compensated employees are reduced under present law may reduce the contributions of the lower-paid highly compensated employees more than the contributions of higher-paid highly compensated employees.

The sources of complexity commonly associated with the special nondiscrimination test for matching and employee contributions are generally the same as those associated with the ADP tests for elective contributions to a cash or deferred arrangement. In a plan that includes both a cash or deferred arrangement and matching

contributions, the prohibition on multiple use of the alternative limitation adds to the complexity.

The special nondiscrimination tests are designed to ensure that the tax benefits for qualified plans are not accruing only to highly compensated employees and that rank-and-file employees actually benefit under the plan. These concerns are particularly acute in the case of elective retirement arrangements. The special nondiscrimination tests for qualified cash or deferred arrangements, matching contributions, and after-tax employee contributions can be modified to reduce complexity without undermining the purposes of the tests.

Explanation of Provision

Nondiscrimination rules relating to qualified cash or deferred arrangements

The bill replaces the present-law two-prong ADP test applicable to qualified cash or deferred arrangements with a single test that is applied at the beginning of the plan year. The bill reduces the complexities associated with present law by (1) reducing the number of calculations that must be performed in order to determine if the test is satisfied, and (2) reducing the need for correction mechanisms by modifying the test so that the maximum possible deferrals by highly compensated employees is known at the beginning of the plan year. In addition, under the bill, the present-law method for reducing excess deferrals and the restriction on multiple use of the alternative limitations are repealed. They are not necessary under the nondiscrimination tests as modified by the bill.

Under the bill, the maximum amount each eligible highly compensated employee can defer is 200 percent of the average deferral percentage of nonhighly compensated employees for the preceding plan year.[4] The average deferral percentage of nonhighly compensated employees is determined the same way as the ADP for such employees under present law. For example, if the average deferral percentage for eligible nonhighly compensated employees is 4 percent, then, under the bill, each eligible highly compensated employee could elect to defer 8 percent of compensation (subject to the dollar limitation on elective deferrals).

In the case of the first plan year of a qualified cash or deferred arrangement, the average deferral percentage for nonhighly compensated employees for the previous year is deemed to be 3 percent or, at the election of the employer, the average deferral percentage for that plan year.

The bill also modifies the permissible correction mechanisms by eliminating the recharacterization method. The number of permissible correction mechanisms increases complexity under present law. In addition, under the bill, correction will be necessary infrequently compared to present law, so that a variety of correction mechanisms is unnecessary.

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[4] This test is similar to the special nondiscrimination test applicable to salary reduction simplified employee pensions (SEPs) under present law.

Nondiscrimination rules relating to employer matching and after-tax employee contributions

The bill conforms the special nondiscrimination test for employer matching and after-tax employee contributions to the rules under the bill regarding qualified cash or deferred arrangements. Thus, under the bill, a plan meets the special nondiscrimination test if the actual contribution percentage of each eligible highly compensated employee for such plan year does not exceed 200 percent of the average contribution percentage of nonhighly compensated employees for the preceding plan year. The actual contribution percentage for an employee is the percentage which the sum of matching contributions and after-tax employee contributions contributed under the plan on behalf of such employee is of such employee's compensation. The average contribution percentage for nonhighly compensated employees for a year is the average of the actual contribution percentages of eligible nonhighly compensated employees for that year.

Effective Date

The provision is effective for plan years beginning after December 31, 1991.

3. Definition of highly compensated employee, cost-of-living adjustments, half-year requirements, and plans covering self-employed individuals (secs. 303-306 of the bill and secs. 72, 219, 401, 403, 408, 411, 414(q), and 415(d) of the Code)

Present Law

Definition of highly compensated employee

In general

For purposes of the rules applying to qualified retirement plans under the Code, an employee, including a self-employed individual, is treated as highly compensated with respect to a year if, at any time during the year or the preceding year, the employee: (1) was a 5-percent owner of the employer; (2) received more than $90,803 in annual compensation from the employer; (3) received more than $60,535 in annual compensation from the employer and was one of the top-paid 20 percent of employees during the same year; or (4) was an officer of the employer who received compensation greater than $54,482. These dollar amounts are adjusted annually for inflation at the same time and in the same manner as the adjustments to the dollar limit on benefits under a defined benefit pension plan (sec. 415(d)). If, for any year, no officer has compensation in excess of $54,482 (indexed), then the highest paid officer of the employer for such year is treated as a highly compensated employee.

An employee is not treated as in the top-paid 20 percent, as an officer, or as receiving $90,803 or $60,535 solely because of the employee's status during the current year, unless such employee also is among the 100 employees who have received the highest compensation during the year.

Election to use simplified method

Employers are permitted to elect to determine their highly compensated employees under a simplified method. Under this method, an electing employer may treat employees who received more than $60,535 in annual compensation from the employer as highly compensated employees in lieu of applying the $90,803 threshold and without regard to whether such employees are in the top-paid group of the employer. This election is available only if at all times during the year the employer maintained business activities and employees in at least 2 geographically separate areas.

Treatment of family members

A special rule applies with respect to the treatment of family members of certain highly compensated employees. Under the special rule, if an employee is a family member of either a 5-percent owner or 1 of the top 10 highly compensated employees by compensation, then any compensation paid to such family member and any contribution or benefit under the plan on behalf of such family member is aggregated with the compensation paid and contributions or benefits on behalf of the 5-percent owner or the highly compensated employee in the top 10 employees by compensation. Therefore, such family member and employee are treated as a single highly compensated employee. An individual is considered a family member if, with respect to an employee, the individual is a spouse, lineal ascendant or descendant, or spouse of a lineal ascendant or descendant of the employee.

Similar family aggregation rules apply in applying the $222,220 limit on compensation that may be taken into account under a qualified plan (sec. 401(a)(17)) and for deduction purposes (sec. 404(l)). However, under such provisions, only the spouse of the employee and lineal descendants of the employee who have not attained age 19 are taken into account.

Cost-of-living adjustments

The rules relating to qualified plans contain a number of dollar limits that are indexed annually for cost-of-living adjustments (e.g., the dollar limit on benefits under a defined benefit plan (sec. 415(b), the limit on elective deferrals under a qualified cash or deferred arrangement (sec. 402(g), and the dollar amounts used in determining highly compensated employees (sec. 414(q)). The Secretary publishes annually a list of the amounts applicable under each provision for the year. Due to the timing of the cost-of-living adjustments, the dollar amounts for each year are not known until after the start of the calendar year.

Half-year requirements

Under present law, a number of employee plan rules refer to the age of an individual at a certain time. For example, distributions under a qualified pension plan are generally required to begin no later than the April 1 following the year in which an individual attains age 70-1/2 (sec. 401(a)(9)). Similarly, an additional income tax on early withdrawals applies to certain distributions from

qualified pension plans and IRAs prior to the time the participant or IRA owner attains age 59-1/2 (sec. 72(t)).

Plans covering self-employed individuals

Prior to the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) different rules applied to retirement plans maintained by incorporated employers and unincorporated employers (such as partnerships and sole proprietors). In general, plans maintained by unincorporated employers were subject to special rules in addition to the other qualification requirements of the Code. Most, but not all, of this disparity was eliminated by TEFRA. Under present law, certain special aggregation rules apply to plans maintained by owner-employees that do not apply to other qualified plans (sec. 401(d)(1) and (2)).

Reasons for Change

Under present law, the administrative burden on employers to comply with some of the basic rules applying to qualified retirement plans outweighs the small potential benefit of the rules. For example, the various categories of highly compensated employees require employers to perform a number of complex calculations that for many employers have largely duplicative results. Similarly, rules triggered by the attainment of fractional ages are difficult to remember and apply but of insignificant benefit to plan participants.

Under present law, adjusted dollar limits are generally not published until after the beginning of the calendar year to which the limits apply. This creates uncertainty for plan sponsors and participants who must make decisions under the plan that may be affected by the limits.

The remaining special rules for plans maintained by unincorporated employers are unnecessary and should be eliminated. Applying the same set of rules to all types of plans would make the qualification standards easier to apply and administer.

Explanation of Provisions

Definition of highly compensated employee

The bill replaces the present law test for determining who is a highly compensated employee with a simplified test. The bill provides that an employee is highly compensated for a year if the employee (1) was a 5-percent owner of the employer during the year or the preceding year, (2) received compensation in excess of $65,000 during the preceding year, or (3) received compensation in excess of $65,000 during the year and was one of the top 100 most highly compensated employees of the employer for the year. As under present law, the $65,000 threshold is adjusted for cost-of-living increases in the same manner as the limitations on contributions and benefits (sec. 415(d)), except that the base period taken into account is the calendar quarter beginning October 1, 1990.

Under the bill, if no employee is treated as being highly compensated under the rules described above, then the employee with the highest compensation for the year is treated as a highly compensat-

ed employee. The bill applies the present-law family member aggregation rule only in the case of family members of a 5-percent owner, and conforms the aggregation rule to the other family aggregation rules by taking into account only the spouse of the employee and lineal descendants of the employee who are under age 19.

Cost-of-living adjustments

The bill provides that the cost-of-living adjustment with respect to any calendar year is based on the increase in the applicable index as of the close of the calendar quarter ending September 30 of the preceding calendar year. Thus, adjusted dollar limits will be published before the beginning of the calendar year to which they apply.

In addition, the bill provides that the dollar limits determined after application of the cost-of-living adjustments are generally rounded to the nearest $1,000. Dollar limits relating to elective deferrals and elective contributions to simplified employee pensions (SEPs) are rounded to the nearest $100.

Elimination of half-year requirements

The bill changes the half-year requirements to birth date requirements. Those rules under present law that refer to age 59-1/2 are changed to refer to age 59, and those that refer to age 70-1/2 are changed to refer to age 70.

Plans covering self-employed individuals

The bill eliminates the special aggregation rules that apply to plans maintained by self-employed individuals that do not apply to other qualified plans.

Effective Dates

The provisions are effective for years beginning after December 31, 1991.

4. Modification of full funding limitation (sec. 307 of the bill and sec. 412 of the Code)

Present Law

Under present law, subject to certain limitations, an employer may make deductible contributions to a defined benefit pension plan up to the full funding limitation. The full funding limitation is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 150 percent of the plan's current liability, over (2) the lesser of (a) the fair market value of the plan's assets, or (b) the actuarial value of the plan's assets (sec. 412(c)(7)).

The Secretary may, under regulations, adjust the 150-percent figure contained in the full funding limitation to take into account the average age (and length of service, if appropriate) of the participants in the plan (weighted by the value of their benefits under the plan). In addition, the Secretary is authorized to prescribe regulations that apply, in lieu of the 150 percent of current liability

limitation, a different full funding limitation based on factors other than current liability. The Secretary may exercise this authority only in a manner so that in the aggregate, the effect on Federal budget receipts is substantially identical to the effect of the 150-percent full funding limitation.

Reasons for Change

The Secretary has not yet exercised his authority with respect to the full funding limitation. It is appropriate to specify a revenue-neutral way of exercising such authority.

Explanation of Provision

The bill allows certain employers to elect to apply the present-law full funding limitation without regard to the 150 percent of current liability limitation. The Secretary is required under the provision to adjust the full funding limitation in a specified manner for all plans (other than those subject to such an election) in response to employer elections under the proposal so that the provision is revenue neutral.

Effective Date

The provision is effective on the date of enactment.

5. Distributions from qualified cash or deferred arrangements maintained by rural cooperatives (sec. 308 of the bill and sec. 401(k) of the Code)

Present Law

Under present law, a qualified cash or deferred arrangement can permit withdrawals by participants only after the earlier of (1) the participant's separation from service, death, or disability, (2) termination of the arrangement, (3) in the case of a profit-sharing or stock bonus plan, the attainment of age 59-1/2, or (4) in the case of a profit-sharing or stock bonus plan to which section 402(a)(8) applies, upon hardship of the participant (sec. 401(k)(2)(B)). In the case of a rural cooperative qualified cash or deferred arrangement, which is part of a money purchase pension plan, withdrawals by participants cannot occur upon attainment of age 59-1/2 or upon hardship.

Reasons for Change

It is appropriate to permit qualified cash or deferred arrangements of rural cooperatives to permit distributions to plan participants under the same circumstances as other qualified cash or deferred arrangements. Rural cooperatives could achieve the same results by modifying the structure of their plans. There is no justifiable reason to require rural cooperatives to incur the administrative costs of plan conversion when the same result can be achieved without imposing such costs.

Explanation of Provision

The bill provides that a rural cooperative plan that includes a qualified cash or deferred arrangement will not be treated as violating the qualification requirements merely because the plan permits distributions to plan participants after the attainment of age 59.

Effective Date

The provision is effective for distributions after the date of enactment.

6. Special rules for plans covering pilots (sec. 309 of the bill and sec. 410(b) of the Code)

Present Law

Under present law, for purposes of determining whether a qualified pension plan satisfies the minimum coverage requirements, in the case of trust established pursuant to a collective bargaining agreement between airline pilots and one or more employers, all employees not covered by the collective bargaining agreement are disregarded (sec. 410(b)(3)(B)). This provision applies only in the case of a plan that provides contributions or benefits for employees whose principal duties are customarily performed aboard aircraft in flight. Thus, a collectively bargained plan covering only airline pilots is tested separately for purposes of the minimum coverage requirements.

Reasons for Change

Present law treats airline pilots covered by a collective bargaining agreement separately for purposes of testing whether a pension plan satisfies the minimum coverage requirements, but requires nonunion airline pilots to be considered with an employer's other employees for coverage purposes. This disparity of treatment can adversely affect the decision of airline pilots to unionize.

In addition, present law may prevent employers who provide pension benefits to nonunion airline pilots from providing benefits to such pilots that are comparable to the benefits provided to airline pilots covered under a collective bargaining agreement. Thus, present law may make it more difficult for employers employing nonunion airline pilots to compete for qualified pilots.

Explanation of Provision

The bill provides that, in the case of a plan established by one or more employers to provide contributions or benefits for air pilots employed by one or more common carriers engaged in interstate or foreign commerce or air pilots employed by carriers transporting mail for or under contract with the United States government, all employees who are not air pilots are excluded from consideration in testing whether the plan satisfies the minimum coverage requirements. In addition, the bill provides that this exception does not apply in the case of a plan that provides contributions or benefits for employees who are not air pilots or for air pilots whose

principal duties are not customarily performed aboard aircraft in flight.

Effective Date

The provision is effective for years beginning after December 31, 1991.

7. Elimination of special vesting rule for multiemployer plans (sec. 310 of the bill and sec. 411 of the Code)

Present Law

Under present law, except in the case of multiemployer plans, a plan is not a qualified plan unless a participant's employer-provided benefit vests at least as rapidly as under 1 of 2 alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of the participant's accrued benefit derived from employer contributions upon the participant's completion of 5 years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to at least 20 percent of the participant's accrued benefit derived from employer contributions after 3 years of service, 40 percent at the end of 4 years of service, 60 percent at the end of 5 years of service, 80 percent at the end of 6 years of service, and 100 percent at the end of 7 years of service.

In the case of multiemployer plan, a participant's accrued benefit derived from employer contributions is required to be 100 percent vested no later than upon the participant's completion of 10 years of service. This special rule applies only to employees covered by the plan pursuant to a collective bargaining agreement.

These same vesting rules also apply under title I of the Employee Retirement Income Security Act of 1974 (ERISA).

Reasons for Change

The present-law vesting rules for multiemployer plans add to complexity because there are different vesting schedules for different types of plans, and different vesting schedules for persons within the same multiemployer plan. In addition, the present-law rule prevents some workers from earning a pension under a multiemployer plan. Conforming the multiemployer plan rules to the rules for other plans would mean that workers could earn additional benefits.

Explanation of Provision

The bill conforms the vesting rules for multiemployer plans to the rules applicable to other qualified plans.

Effective Date

The provision is effective for plan years beginning on or after the earlier of (1) the later of January 1, 1992, or the date on which the last of the collective bargaining agreements pursuant to which the plan is maintained terminates, or (2) January 1, 1994, with respect to participants with an hour of service after the effective date.

8. Definition of retirement age (sec. 311 of the bill and secs. 401(a)(14) and 411 of the Code)

Present Law

A qualified plan is required to provide that, unless the participant elects otherwise, the payment of benefits under the plan is to begin no later than the 60th day after the latest of the close of the plan year in which (1) the participant attains the earlier of age 65 or the normal retirement age specified under the plan, (2) occurs the 10th anniversary of the year in which the participant commenced participation in the plan, or (3) the participant terminates service (sec. 401(a)(14)). Under the Code and title I of ERISA, for purposes of the rules relating to vesting and accrual of benefits, normal retirement age means the earlier of (1) the time a participant attains normal retirement age under the plan, or (2) the later of the time a participant attains age 65 or the 5th anniversary of the time a plan participant commenced participation in the plan.

For purposes of the limits on contributions and benefits (sec. 415) the retirement age under social security (with certain modifications) is generally used as normal retirement age.

Reasons for Change

Some employers would like to use social security retirement age as the normal retirement age under their qualified plan. The present-law definitions of normal retirement age may prevent them from doing so. Allowing employers to use social security retirement age would simplify plan administration, and would also conform the definition to the rule in effect for purposes of the limits on contributions and benefits.

Explanation of Provision

The bill amends the definitions of normal retirement age by replacing age 65 with the social security retirement age (as determined under sec. 415(b)(8)).

Effective Date

The provision is effective for years beginning after December 31, 1991.

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